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Gordon Lindhurst MSP
Convener of the Economy, Energy and Fair Work Committee

23 November 2018

Dear Mr Lindhurst

Damages (Investment Returns and Periodical Payments) (Scotland) Bill – Additional evidence from the Association of British Insurers

At the oral evidence session with the Committee on 30th October, I said I would write to the Committee to follow up on a number of points that were raised during the discussion.

Data of the average life expectancy of a serious in injured claimant

In order to support the ABI's work on engaging with officials last year on proposals to reform the methodology for setting the Discount Rate, we collected data on the average life expectancy following a serious personal injury claim with damages over £250,000 and so where the application of the discount rate has a significant impact on the overall award. We found the average life expectancy was 46 years[1].

Given this, we have concerns about how the 30 year investment period (which is reflected on life expectancy) has been calculated given industry data shows it is substantially higher.

In their report to the Scottish Government dated 5 September 2018 GAD gave their reasoning for the 30 years at paragraph 4.5:
This means that the claimant outcomes considered in this report are likely to be highly sensitive to the length of the award and the 30 year award period presented is intended to be illustrative rather than representative. That said 30 years can broadly be considered as somewhere between "short" awards (for example given to those with severe injuries, lower life expectancy or older claimants) and "long" awards (for example given to younger claimants). The award is also broadly consistent with "loss of earnings" damages awarded to a claimant in their mid-late 30s (as included in the consultation document).

GAD noted at Figure 8 and paragraphs 8.14 and 8.15:
8.14 The chart shows that for a given PI discount rate approach (eg E[Real return] - 0.5%), the probability of pursuers being under-compensated and the expected level of over-

[1] Data was collected from 11 insurers, representing 67% of the motor market, 41% of the employers liability market, and 59% of the general market overall. Overall, 2760 claims were considered, some members provided only claims from 2016, while others provided data from a broader timescale and there is a mixture of settled and live cases. These are based on UK claims rather than Scottish specific.

compensation are sensitive to the assumed award period. Broadly speaking, as the assumed award period increases:
> the probability of under-compensation decreases; and
> the expected level of over compensation increases.
8.15 This is broadly because over longer periods, it is more likely that any period of poor investment performance can be recovered.

The ABI's data demonstrates that 30 years is not an accurate conclusion and given the sensitivities highlighted by GAD that this creates should be addressed by increasing the 30 year investment period assumption. Furthermore, the Scottish Minister acknowledged the weakness of the 30-year period in her evidence to the Committee.

As we have noted previously, the 30 years cannot be considered in isolation. Pannells in their report stated:

In addition Equity investments generally provide some protection against inflation over the longer term as you would expect the values of company shares to increase in real terms over time.

The combination of an over-cautious portfolio and a shorter investment period reduces the opportunities to derive better returns against inflation by investing in equities. Addressing both those points should also help avoid the need to apply a further margin. Furthermore, for the most cautious pursers who want a risk-free approach, a PPO would be the most suitable option.

Comment on Pannell's view on life expectancy

Pannells, in the evidence they produced for the Committee, indicated that they considered that 30 years is a reasonable assumption for life expectancy. However, it is important to note that this is in the context of this being classed as a long-term investment period – which they consider to be a period of 16 years or more. They link long-term investment periods to the reduction in risks in Equity investments, which is why they advocate a higher equity content. As highlighted above, industry data shows that the average is 46 years.

Pannells, in providing their report, were not privy to this data nor were they specifically asked to comment on the 30-year assumption in the context of it. They were not asked whether the 46 year period would be appropriate and have therefore not to our knowledge, commented on the point.

The further margin adjustment

The Scottish Government has not presented any evidence of the under-compensation which the further margin is intended to counter. The decision to over-compensate pursuers (to avoid under-compensation), as laid out in the Government's supporting policy documents, runs contrary to the Scottish Government's decision that pursuers should receive 100% compensation – which is reflected in paragraph 17(4) of Schedule B1 which describes "*someone whose objectives are of securing that the damages will (a) meet the losses and expenses for which damages are awarded, and (b) be exhausted at the end of the period for which the damages are awarded*".

The use of the Further Margin of 0.5% to avoid under-compensation is a very blunt instrument to use to achieve that end, which will, rather than allow for 100% compensation, lead inevitably to over-compensation.

The Bill states that the expression of the rate set is to be set in steps on 0.25%. The margin of 0.5% therefore represents two points of rounding down and could have a very significant impact on the overall rate.

Rather than allow for a further margin, in our submission, it would be better to determine the appropriate rate and then round that down to the nearest 0.25% step. This would allow for the over-compensation that is the stated policy, but would not be as blunt an instrument or represent such a significant departure from the principle of 100% compensation.

Level of risk

Pursuer risk

A number of stakeholders who gave evidence on the claimant lawyer session argued that a pursuer should be considered to be risk free. However, it is important to understand that there is no such thing as risk free investment. Any form of investment carries an element of risk and there is general agreement that no properly advised pursuer would invest solely in ILGS or indeed any single asset class.

Should a pursuer wish to avoid risk, they have the option to choose a Periodical Payment Order (PPO). This is the only way to remove the risk to the pursuer altogether – should that be the desired objective – as this option would reduce exposure to *both* investment risk *and* longevity risk.

Review period

The Committee are also requested to recommend that the rate review period be increased from three to five years. A three year review period will lead to almost continuous "gaming" of the system, with parties either seeking to settle early or delay settlement due to an imminent rate change. A five year period remains short enough not to disadvantage parties, but long enough to mitigate against the constant "gaming", which could of course drive an increase in court hearings if parties are reluctant to settle by negotiation.

The provisions in the Bill for earlier review if necessary in the context of any significant economic event can be addressed by an earlier change in rate should it be required. It is important to recognise that it is the long term investment position that needs to be considered on such reviews, such that events with a short-term impact are unlikely to trigger the need for a review.

I hope the above information if helpful. Please do not hesitate to contact me if you require any further information or clarification.

Your sincerely

James Dalton
Director of General Insurance Policy